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## **S. 1260 — The Securities Litigation Uniform Standards Act of 1998**

Calendar No. 355

Reported May 4, 1998 from the Committee on Banking, Housing and Urban Affairs with an amendment in the nature of a substitute by a vote of 14-4 (Senators Shelby, Sarbanes, Bryan and Johnson voting no). S. Rept. 105-182. Additional views were filed.

### **NOTEWORTHY**

- In 1995, Congress passed — over a Presidential veto — the Private Securities Litigation Reform Act to stop abusive federal securities class action lawsuits.
- Today, that law is being circumvented by plaintiff lawyers who are bringing actions in state court rather than federal court. Prior to 1995, few class actions involving nationally traded securities were brought in state court.
- S. 1260 is designed to prevent plaintiff lawyers from circumventing existing law by establishing uniform standards governing private class actions involving nationally traded securities.
- The legislation is expected to be considered under a unanimous consent agreement that would limit debate time and would allow several Democrat amendments to be offered [see Possible Amendments].

### **BACKGROUND**

In 1995, Congress passed the Private Securities Litigation Reform Act [Pub. Law No. 104-67] (hereinafter called the "1995 Act") to end abusive federal securities class action lawsuits

and to increase the flow of information to investors. The 1995 Act was the first bill enacted over President Clinton's veto.

During a Committee hearing on implementation of the 1995 Act, testimony showed that federal reforms were being circumvented by class action lawsuits being brought in state courts. While the exact number of cases that have shifted from federal to state court is unknown, it is clear that prior to enactment of the 1995 Act, "state-court class actions involving nationally traded securities were virtually unknown prior to the [1995 Act]; they are brought with some frequency now" [Written testimony of John F. Olson, Hearing on S. 1260, 2/23/98, as quoted in the Committee Report, p. 4.].

To address these concerns, this bill would amend the 1933 Securities Act and the 1934 Securities Exchange Act to establish uniform standards governing private class actions involving companies issuing nationally traded securities. Some critics have attacked the legislation as being an affront on Federalism. Proponents of the legislation argue that securities are traded in national markets and that uniform standards are consistent with the federal government's role in promoting free trade and interstate commerce.

The legislation does not interfere with the ability of state officials to file cases in state courts, nor with the ability of individual litigants to seek relief in state courts for actions involving 50 or fewer plaintiffs. The bill does, however, does provide a definition for "class action" [Section 2(f)(1)(A)(ii)] that is intended to prevent evasion of the bill through the use of so-called "mass actions" or other actions that might be used to circumvent the 1995 Act. On the other hand, the "Committee does not intend [with a stated exception] for the bill to prevent plaintiffs from bringing bona fide individual actions simply because more than fifty persons commence the actions in the same state court against a single defendant" [Committee Report, p. 7].

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## **BILL PROVISIONS**

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### **Section 1: Short Title**

### **Section 2: Findings**

- Congress finds that since enactment of the Private Securities Litigation Reform Act of 1995, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts.
- To prevent State class action lawsuits from being used to frustrate the objections of the 1995 Act, national standards for nationally traded securities must be enacted, while preserving the appropriate enforcement powers of state regulators, and the right of individuals to bring suit.

### **Section 3: Limitation on Remedies**

- Subsection 3(a) amends Section 16 of the Securities Act of 1933 by providing that:

- No class action based on State law alleging fraud in connection with the sale or purchase of "covered securities" may be maintained in State or Federal court [Sec. 16(b)];
- Any class action brought in State court involving a covered security shall be removable to a Federal district court, and may be dismissed pursuant to the provisions of subsection (b) [Sec. 16(c)].
- An exception is made to preserve certain law suits brought under State law affecting the conduct of corporate officers with respect to certain corporate actions, including tender offers, exchange offers or the exercise of dissenter's or appraisal rights [Sec. 16(d)].
- This subsection also emphasizes that state securities commissions retain their jurisdiction to investigate and bring enforcement actions [Sec. 16(e)].
- Finally, this subsection provides a set of definitions, including definitions of "class action," "covered security," and "affiliate of the issuer."
  - "Affiliate of the issuer" means "a person that directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the issuer" [Sec. 16(f)(1)].
  - "Class action" is defined to include any lawsuit or group of lawsuits where damages are sought on behalf of more than 50 persons. The definition is intended to capture "mass actions," but to exclude shareholder derivative actions and actions by a group of less than 50 individuals or entities [Sec. 16(f)(2)].
  - "Covered securities" means a security that satisfies the definition of that term given in subsection 18(b)(1) and 18(b)(2) of the Securities Act of 1933 [Sec. 16(f)(3)].
- Subsection 3(b) of the bill amends Section 28 of the Securities Exchange Act of 1934 to make that section consistent with the amendments made by Subsection 3(a) to the Securities Act of 1933.

#### **Section 4: Applicability**

- Changes in law made by this bill are not intended to affect any court action commenced before and pending on the date of enactment of the legislation.

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### **ADMINISTRATION POSITION**

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No formal Statement of Administration position was available at press time. However, Senators D'Amato, Gramm and Dodd received a letter dated April 28, 1998 from Bruce Lindsey and

Gene Sperling at the White House indicating that as long as amendments designed to address concerns raised by the Securities and Exchange Commission (SEC) were added to the legislation, the Administration would support S. 1260. These concerns were accommodated during markup. The SEC had asked for clarification that debate on the 1995 Securities Litigation Reform Act did not, nor was it intended to, alter the scienter standard for securities fraud actions. The Committee Report includes language clarifying the debate.

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## COST

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The Congressional Budget Office estimates that "implementing S. 1260 would have no significant impact on the federal budget." CBO estimated that the federal court system would not incur significant costs to process the new cases, since it was anticipated that fewer than 100 cases a year might shift to federal courts as a result of this legislation.

CBO also determined that S. 1260 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act of 1995 because it would preempt state securities laws. However, CBO concluded that the bill would not significantly impact state budgets.

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## OTHER VIEWS

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**Senators Sarbanes, Bryan and Johnson:** These Senators argue that the evidence does not support the argument that the 1995 Act is being undermined by actions brought in state courts. They also oppose this bill, as they did the 1995 Act, because it does not correct the flaws in the 1995 Act. They are concerned that in too many cases, investors will be left without any effective remedies at all. In particular, these Senators expressed concern with a "safe harbor" for forward looking statements, proportionate liability, and failure to restore liability for aiders and abettors.

With respect to the substance of the Uniform Standards bill, these Senators are concerned that the bill's definition of "class action" is still too broad; the "unduly" short federal statute of limitations would not apply "in an unfair manner" to State cases; and the bill fails to codify liability under the Federal antifraud provisions for reckless conduct.

**Senator Reed:** This Senator supports this Act and wants to emphasize that the legislative language preserves the recklessness standard.

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## **POSSIBLE AMENDMENTS**

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As noted previously, it was anticipated the bill would come to the floor with a u.c. limiting amendments. Three amendments considered and rejected in Committee might be re-offered on the floor:

Sarbanes. State law statute of limitations should apply.

Sarbanes. State law relating to aiding and abetting would continue to apply.

Sarbanes. Narrow definition of "class action" by eliminating "mass action."

Senator Sarbanes also proposed an amendment that was withdrawn to address micro-cap securities.

Additionally, an amendment might be offered regarding the recklessness standard.

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